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In the Supreme Court of the United States

OCTOBER TERM, 1977

EPH H. HOOVER, JR. AND LUCINDA HOOVER, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

DANIEL M. FRIEDMAN,
Acting Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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The sole question presented by the petition in this federal income tax case is whether the courts below correctly held that certain payments by petitioner Eph Hoover[1] to a corporation of which he was the principal shareholder were not deductible as business bad debts and therefore resulted in capital rather than ordinary losses.

Petitioner was a principal shareholder in a group of related corporations engaged in the road construction business. He also was an officer of each of the corporations and drew from them an annual total salary

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[1]The term "petitioner" refers to Eph Hoover. Lucinda Hoover is a party only because she filed joint income tax returns with her husband for the years involved.

of approximately $20,000. Petitioner had additional income of approximately $131,000 per year. In 1963 and 1964, petitioner personally guaranteed loans of approximately $800,000 to one of the corporations. In 1966, the borrowing corporation defaulted on the loans and petitioner paid approximately $594,000 on his guaranties (Pet. App. A-3, A-4).

On audit, the Commissioner of Internal Revenue disallowed petitioner's claimed business bad debt deduction for the payment on his guaranties. The Commissioner determined that the payment was a nonbusiness bad debt that resulted in a capital loss under Section 166(d) of the Internal Revenue Code of 1954, as amended (26 U.S.C.). In this refund suit brought by petitioners in the United States District Court for the Middle District of Tennessee, petitioner testified that his dominant motive was to protect his salaried position so that the loss resulting from the payment of his guaranty was from a business bad debt under *United States* v. *Generes*, 405 U.S. 93. Although the jury found in favor of petitioner, the district court set aside its verdict on the ground that it was "not credible" that petitioner's dominant motive was to protect a salary that was small when compared to his other income, his investment in the corporations, and his personal liability as a guarantor (Pet. App. A-1 to A-5).

The court of appeals affirmed by order (Pet. App. A-6 to A-8). It held that the "overwhelming disparity" between petitioner's investment in the corporations and his salary permitted "no reasonable conclusion other than that his dominant motivation in making the payment was to protect his substantial shareholder investment" (Pet. App. A-7).

The decision below is in accord with *United States* v. *Generes*, *supra*. There, as here, a jury accepted the

taxpayer's testimony that he was motivated by a desire to protect his job. However, this Court held that the objective economic evidence would not support the conclusion that the taxpayer's dominant motive in making the guarantee was to protect his salaried position with the corporation.[2]

Petitioner contends (Pet. 7) that the district court misapplied the *Generes* rule by relying "solely on the numerical comparisons" and that it "completely ignored any evidence favorable to the petitioner." But the numerical comparison—*i.e.*, the disparity between the taxpayer's financial stake in his investment as compared to his salaried position—is precisely what the Court in *Generes* held to be dispositive. While petitioner emphasizes that he devoted himself full-time to his contracting business, the court of appeals properly held that this was not a basis upon which to distinguish *Generes*.[3]

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

DANIEL M. FRIEDMAN,
Acting Solicitor General. *

DECEMBER 1977.

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[2]Indeed, the government's position in this case is even stronger than *Generes*. There, the after-tax ratio of investment to salary was about 5 to 1 (405 U.S. at 107). Here, the ratio ranged from 20 to 1 to 75 to 1 (Pet. App. A-5).

[3]*Anderson* v. *United States*, 555 F. 2d 236 (C.A. 9), upon which petitioner relies (Pet. 7, 9), is not to the contrary. There, the court affirmed a finding that the dominant motive of a taxpayer-lender was to protect his job rather than his investment in the corporate borrower. Here, however, both courts below ruled that the objective economic evidence could not support such a finding.

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*The Solicitor General is disqualified in this case.

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